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RUEHBU/AMEMBASSY BUENOS AIRES 3949  
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RUEHMN/AMEMBASSY MONTEVIDEO 6186  
RUEHSG/AMEMBASSY SANTIAGO 5445  
RUEHPE/AMEMBASSY LIMA 2950  
RUEHCV/AMEMBASSY CARACAS 3199  
RUEHQT/AMEMBASSY QUITO 1785  
RUEHLP/AMEMBASSY LA PAZ 4511  
RUEHBO/AMEMBASSY BOGOTA 3698  
RUEHBJ/AMEMBASSY BEIJING 0300  
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SUBJECT: REINING IN PETROBRAS' PARADE

REF: A) Brasilia 24, B) 05 Brasilia 1503  
C) La Paz 968

¶1. (SBU) Summary. Evo Morales' address at the opening ceremony of the Inter-American Development Bank (IDB) meeting in Belo Horizonte, along with the Bolivian IDB governor's speech, gave some discomfort to Petrobras' leadership, which is currently in the midst of increasingly tense contract negotiations with the Bolivian Government both over both the periodic review of gas prices and the Morales government's desire to nationalize the hydrocarbons industry. An 800 meter pipeline break and reported delays in making repairs have exacerbated doubts about Bolivia's reliability as a gas supplier. On the full array of Brazil-Bolivia issues, while Brazilian energy-sector leaders, from the Minister of Mines and Energy to parastatal Eletrobras, publicly have deferred to Petrobras, they have concerns about the net effect on short term energy prices and future demand. The Brazilian Presidency is trying to distance itself from the increasingly tense negotiations, preferring a market solution. However, recent events may require higher level intervention. End Summary.

¶2. (U) At the opening Ceremony of the Inter-American Development Bank meeting in Belo Horizonte, President of Bolivia Evo Morales told the audience that Bolivia is looking for partners, not bosses ("patrones") or colonizers and that the plundering of his country's natural resources must stop. The Bolivian IDB governor reiterated his President's words and added that it will be necessary to deconstruct the current neo-liberalist, colonialist structure currently in place in the country. There already had been signals that negotiations between Petrobras and the government of Bolivia would be difficult, but Morales' strong rhetoric and ensuing negotiations with Petrobras, the week of April 7, have exacerbated Brazilian worries about reliability of their gas supply.

¶3. (U) Petrobras investment in Bolivia represents two percent of the company's investments worldwide (ref A). The gas from

Bolivia-Brazil pipeline accounts for 43 percent of natural gas consumption in Brazil, according to Brazil's National Petroleum Agency. Although Petrobras fully expects the amount of taxes it pays in Bolivia to increase, Gabrielli publicly reminded Morales during the IDB meetings that Bolivia has a great deal to lose should renegotiation of contracts go awry. Gabrielli catalogued Bolivia's points of dependence: gas exports to Brazil represent 66 percent of Bolivian exports, 33 percent of Bolivia's tax base, provide stable work for many Bolivians, and act as an anchor of international investment in the country. According to the contract currently in effect between Petrobras and the Bolivian government, price adjustments are to occur every trimester with its basis calculation the prior six months' variation on a basket of oil derivatives (found in Platt's).

#### COMPLICATIONS

14. (U) On March 31 heavy rain damaged 800 meters of the pipeline between the two countries and Bolivian protests blocked repair crews from reaching their destinations, which reportedly has delayed the repair job and increased concerns in Brazil about Bolivia's reliability as a gas supplier. The break resulted in an estimated 2.5 million cubic meter per day reduction of gas supply and the full repair will likely take until the first week of May. Brazilian Minister of Mines and Energy Silas Rondeau informed thermal electric power plants that they might have to live with up to a 72 percent reduction in supply while gas and cooking gas processing companies might have to cope with a 51 percent reduction. The Minister did not contemplate any more problematic scenarios materializing - i.e., gas rationing at the extreme (a 10 million cubic meter per day drop in supply). At this time, most of the hydroelectric water

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reservoirs are at full capacity, so the effect on spot electricity prices is expected to be null. However, many press reports say that the cost of processed gas will increase in May.

15. (SBU) One of Petrobras' large gas customers, sister parastatal Eletrobras, is in the hot seat as it plans to increase electricity production capacity with natural gas. Currently natural gas generated electricity accounts for 19 percent of the electricity supply in Brazil. Asked about the security of Bolivian gas supply in a post-Morales-speech presentation at the IDB meetings, Eletrobras President Aloisio Vasconcelos Novais publicly deferred to his colleagues at Petrobras as they sought to complete the necessary negotiations with the Bolivian government. But in an off-the-record aside with select reporters and econoff on the margins of his presentation, he said Eletrobras' efforts to improve its performance depend upon completion of some Sarbanes-Oxley requirements and on the stable supply of gas, the majority of which comes from Petrobras.

16. (SBU) For its part, Petrobras is hedging its bets. Although in a recent conversation with Consulate Rio Econ/Pol assistant, company reps sought to downplay published reports that negotiations had soured, Petrobras Oil and Gas Chief Ildo Sauer recently announced to the press that the company was looking at the feasibility of purchasing liquefied natural gas (LNG) from countries such as Nigeria, Trinidad and Tobago, Egypt, and Russia. Given the US\$400 million expense associated with constructing an LNG re-gasification plant - and Petrobras is considering the possibility of building two - it is not clear whether the Bolivians will consider this to be a serious threat. On April 17, Petrobras also announced a US\$239 million deal with Chinese parastatal Sinopec Group to build a section of Petrobras' Southeast-Northeast Gas Pipeline Interconnection (GASENE) project, part of its efforts to improve efficiency in transporting gas within Brazil. Meanwhile, senior Brazilian officials have been careful to allow Petrobras to take the lead in the negotiations. Lula's foreign affairs advisor, Marco Aurelio Garcia, stated to the press that "if there has been a hardening of positions, it has not been from our side."

#### COMMENT

17. (SBU) The highest levels of the Brazilian government have attempted to keep a low profile in the debate, maintaining a delicate balance between President Lula's friendship with Morales, public scrutiny of its relationship with nominally privatized Petrobras and its determination to protect Brazilian interests. The Brazilian government repeatedly has told us that while they are (or perhaps were) willing to put some financial incentives on the table - such as the mooted petrochemical complex on the Brazil/Bolivia border - that they would not accept outright nationalization of Petrobras assets. And, while Brazil's leadership has consistently called for a negotiated solution to the impasse between Bolivia and Petrobras, it will become increasingly difficult for the Brazilian government to stay out of the fray. In an election year, with other problems looming, this could get interesting for Lula. End Comment.

Chicola